COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

SECOND SET OF INFORMATION REQUESTS TO
DIRECT ENERGY MARKETING, INC.
D.T.E. 04-01
July 14, 2004

Respondent: Patrick Jeffery

DTE-2-1 All parties should comment on the nature and magnitude of any potential commodity-cost implications of a shift to a path, rather than slice of system, approach to capacity assignment, as raised in Bay State Gas Company's Reply Comments, at p. 6.

Response: 2-1. Whether Massachusetts adopts a slice of system approach or a path approach, commodity-cost differentials will exist because they are a function of the LDC's supply portfolio. How one allocates capacity does not eliminate them, or cause them. Thus, the issue in shifting to a path approach is how to address these differentials equitably. Direct Energy suggests that mechanisms such as a credit/surcharge approach could be used to address such issues.

In proposing a shift from the slice of system approach to the path approach in its Reply Comments, Direct Energy encouraged the Department to adopt a credit/surcharge cost adjustment mechanism to preclude cost shifting and cost inequities. Thus, one of the basic tenets of the proposed approach is to implement a credit and surcharge cost adjustment mechanism which will adjust the cost of each available path so that the net cost of any particular path is equal to the utility's weighted average system cost. This process for establishing a credit/surcharge could consist of an initial cost estimate followed by a subsequent true-up for actual costs. A fair initial cost estimate of relative path costs can be made using standard pricing tools (i.e., NYMEX forward prices and location differentials). Path cost differences subsequently can be addressed by the surcharge/credit mechanism. Direct Energy suggests that this approach could be used to address allocation and recovery of costs of the type referenced in Bay State's example.

In its Reply Comments, Bay State suggested that addressing commodity cost differentials among various paths would be "very complex" and would involve "increased administrative cost." Bay State Reply Comments at 7. The issue facing the Department is whether mitigating any commodity cost differentials under the path approach would be more complex and burdensome than the current slice-of-system approach, which marketers know to be sufficiently complex and burdensome so as to stifle the further development of the competitive market. Direct Energy believes that a fair and equitable path system could be developed that would minimize any administrative burden and that would be far preferable to the current slice of system approach. Moreover, it would be unfortunate to reject the path approach based solely on the hypothetical complexity associated with mitigating commodity cost differentials. Direct Energy encourages the Department to investigate further, on a collaborative basis, whether Direct Energy and other marketers are correct in their initial assessment that a well-designed path system is far superior to the current system in administrative complexity and at least its equal in fairness and equity.

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DTE-2-2 Please provide a discussion of other potential implications, besides commodity costs addressed in the previous Information Request, of a shift to the path-based capacity-assignment standard.

Response: 2-2. Please see response to DTE-2-1.

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DTE-2-3 Discuss the question as to (i) whether a shift to the path capacity-assignment standard will ease administrative burdens of contract management and thereby increase competitiveness of marketers and (ii) assuming a fully and workably competitive Massachusetts gas market, whether the impact of path-specific commodity-cost differentials will diminish as transportation volumes increase as a percentage of LDC throughput.

Response: 2-3. (i.) As Direct Energy has stated in its Reply Comments, Direct Energy believes that a shift to the path approach will reduce fragmentation and therefore, will reduce administrative burdens. Direct Energy believes that a shift to the path capacity assignment method will increase competitiveness of marketers because currently the costs associated with fragmented contracts and stranded capacity are not shared by LDCs. This results in the marketers having higher average costs than the LDCs, thereby putting the marketers at a competitive disadvantage.

Under the current system, a marketer serving non-grandfathered customers that exceed the minimum threshold for mandatory capacity allocation, could manage 81 capacity release contracts for interstate pipeline transportation and storage capacity (*i.e.*, Algonquin: 24 contracts; Dominion: 6 contracts; Granite State: 2 contracts; Iroquois: 3 contracts; National Fuel: 2 contracts; Portland: 1 contract; Tennessee: 22 contracts Texas Eastern: 21 contracts). Moreover, it is possible that all of these contracts could change every month.

In addition to the number of contracts that must be managed, many of the transportation contracts are very small in size, frequently less than 100dth/d, or even 10dth/d. Many of the contracts also have multiple primary paths within the contract, requiring marketers to acquire small volumes of supply at many receipt points to retain the "primary firm" designation that keeps the contract from suffering curtailments by the pipeline during Operational Flow Order (OFO) incidents. For example, if a hypothetical marketer were allocated 1,000dth/d mandatory capacity by Bay State for both Algonquin and Tennessee deliveries (a total of 2,000dth/d), the marketer would need to purchase the following supplies to use its transportation capacity as "secondary-firm within-the-path:"

Supply Source	**Required Daily Vol**
TET STX	39
TET ETX	22
TET WLA	44
TET ELA	80
MNE Beverly	93
TCPL WADD	133
TCPL Niagara	45
TCPL E Hereford	111
TENN Z0	21
TENN ZL	39
	627

Small odd quantities such as these frequently are not commercially available. In addition, the numerous transportation paths created by the many supplies and the many primary delivery points within the transportation contracts makes scheduling very complicated. The marketer is frequently left in a position of stranding capacity rather than bearing the operational costs associated with trading and scheduling so many paths and points.

Thus, as discussed in Direct Energy's Reply Comments, Direct Energy believes that the current capacity allocation system must be consolidated and simplified, both with respect to the number of contracts that are released and the number of transportation paths within those contracts. By adopting a path approach with a credit/surcharge mechanism, Direct Energy believes that the Department will reduce capacity fragmentation and the administrative costs related thereto which will allow marketers to provide more competitive pricing to their customers.

(ii.) Please see response to DTE-2-1.

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DTE-2-4 Assuming the Department were to adopt a standard of path-based capacity assignment, please enumerate and discuss what Terms and Conditions changes might be necessary to implement such a shift.

Response: 2-4. In order to implement a shift to the path capacity assignment approach, certain changes to Sections 2.0 and 13.0 of the Terms and Conditions would be required. Specifically, Sections 13.3, 13.4, 13.5 and 13.6 would need to be modified to reflect the change from a slice of system approach to a path approach. In general, the modified Terms and Conditions would need to reflect the following:

1. A methodology and process for selection and awarding of paths, including a means of resolving any over-subscriptions to particular paths;

2. A methodology and process (credit and surcharge plan) for balancing any cost differences between available paths to avoid cost inequities and/or cost shifting; and

3. A methodology and process for determining and releasing paths on an annual basis to prevent inequities among early and late entrants.

As noted in Direct Energy's Reply Comments, the mechanics of the Rhode Island approach of posting capacity paths annually and assessing credits/surcharges is reflected in the language of New England Gas Company's Tariff 101. *See New England Gas Company, Rhode Island Public Utilities Commission Tariff No. 101, Section 6, Transportation Terms and Conditions, Schedule C, 1.07.0 Capacity Release (effective Oct. 1, 2003).* The Capacity Release provision of this tariff is attached to Energy East's Initial Comments.

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DTE-2-5 What Terms and Conditions changes might need to be implemented in order that a shift to the path capacity-assignment standard would spare firm and transportation customers of any commodity-cost subsidization?

Response: 2-5. Please see response to DTE-2-4.

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DTE-2-6 Each LDC should address whether or not it releases capacity on a monthly basis or some other basis, such as the term of the underlying contract, noting the relevant provisions of the company's Terms and Conditions, and explaining any variance from those provisions.

Response: 2-6. N/A

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DTE-2-7 If the Department was to decline to adopt the terms and conditions changes proposed by the marketers and adopted a path approach instead of a slice of system approach, please address the effect on system operations and competition.

Response: 2-7. As Direct Energy stated in its Reply Comments, the Department should work towards the immediate objective of implementing modifications to the current capacity assignment system specifically designed to mitigate administrative costs and the risk imposed on new entrants into the Massachusetts gas market. Direct Energy believes that substituting a path plus credit/surcharge approach for the current slice of system approach and modifying the non-daily metered program to ensure more consistency between nominated and actual values are both important changes that together, will help meet this objective.

If the Department only adopts the path approach but does not implement modifications to the non-daily metered program, there will continue to be problems with management of supply and demand which ultimately results in higher costs for all customers. Direct Energy believes that the modifications it suggests for the non-daily metered program are important components to achieving a capacity assignment system which encourages marketers to participate in the market. Specifically, Direct Energy believes that requiring the LDCs to provide sufficient information to the marketers to allow the marketers to replicate the process and results the LDC uses to develop the daily delivery requirements for non-daily metered customers will minimize imbalances by allowing better management of supply and demand. In addition, revising the summer and winter month algorithms to reflect consumption more accurately and allowing more frequent "true-up" of actual versus delivered volumes will encourage more accurate forecasting by the LDCs and will lower costs for all participants.

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DTE-2-8 If the Department were to adopt the terms and conditions changes proposed by the marketers and maintained the slice of system policy, please address the effect on system operations and competition.

Response: 2-8. As Direct Energy stated in its response to DTE-2-7, Direct Energy believes that both modifications to the Terms and Conditions and a switch to the path approach are vital components to designing a system of capacity assignment which mitigates administrative costs and the risk imposed on new entrants into the Massachusetts gas market. If the Department were to decline to adopt the path approach, the problems of fragmentation of capacity contracts, administrative burdens and stranded costs will continue to hinder the Massachusetts system for capacity assignment.